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FINANCIAL SITUATION OF UNIDO

Operational budget

Report of the Director-General

Summary

Reports on the review of the required scope and content of the operational budget and of its relationship to the regular budget.

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Introduction

1. In its conclusion 94/2, paragraph (c), the Programme and Budget Committee requested the Director-General to review the required scope and content of the operational budget and of its relationship to the regular budget, taking into account the approved structural reform of UNIDO and the reduction of estimated income in the operational budget, and to report on his findings and recommendations to the Industrial Development Board at its thirteenth session.

2. In undertaking this review, consideration was given to the extensive report on the operational budget prepared by the independent team of experts in 1989 (PBC.5/16). The present review takes account of the rapidly changing operational environment and, in particular, of (a) the declining levels of technical cooperation delivery; (b) the impact of the United Nations Development Programme (UNDP) successor arrangements; (c) the availability of information on the identification of project support costs within UNIDO; and (d) the impact of the priorities and structural reform of UNIDO.

I. SCOPE AND CONTENT OF THE OPERATIONAL BUDGET

A. Legislative framework

3. Review on the scope and content of the UNIDO operational budget should be undertaken having regard to the Constitution, which draws a distinction between regular and operational budget activities. The importance placed on UNIDO operational activities led to the inclusion in the Constitution of a separate budget covering technical cooperation activities. Article 13 of the Constitution provides for:

(a) A regular budget which relates to "expenditures to be met from assessed contributions" comprising "expenditures for administration, research and other regular expenses of the Organization and for other activities as provided for in Annex II". These include "programme support costs arising from technical assistance projects, to the extent that these costs are not reimbursed to the Organization by the source of financing of such projects". Annex II.B to the Constitution further provides for the regular budget to finance, in the amount

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of 6 per cent of the total of the regular budget, activities formerly financed out of Section 15 of the United Nations regular budget (Regular Programme of Technical Cooperation).

(b) An operational budget which relates to "expenditures to be met from voluntary contributions to the Organization and such other income as may be provided for in the financial regulations" comprising "expenditures for technical assistance and other related activities".

4. While in the Constitution "operational budget" refers to the budget financed from voluntary contributions, the term is often used more narrowly in reference to the income derived from the partial reimbursement for technical cooperation (extrabudgetary) support costs and the expenditures financed from this income. The present review discusses the operational budget in this narrower sense.

B. Technical cooperation levels

5. The scope of the UNIDO operational budget is dependent, in the first instance, on the level of voluntary contributions made available to the Organization to provide direct technical assistance to developing countries. Technical cooperation expenditures by major sources of funding from 1987 to 1993 (including Regular Programme of Technical Cooperation) are provided in the annex to the present document.

6. As can be seen from the annex, the relative proportions of technical cooperation expenditures by source of funding to total expenditures has changed markedly since 1987. In particular, the level of resources from UNDP fell from 72.4 per cent (\$70.7 million) of expenditures during 1987 to 34.6 per cent (\$41.1 million) in 1993. Non-UNDP funding, excluding the Regular Programme of Technical Cooperation, increased in the same period of time from \$24.9 million to \$67.9 million.

7. UNIDO receives reimbursement for support costs incurred in the execution and implementation of technical cooperation projects. That income for the period 1987 to 1993 is shown in the annex to the present document.

C. Cost components of technical cooperation support

8. In order to discuss "the required scope and content of the operational budget and of its relationship to the regular budget", it is important to identify the total support cost and composition of the cost of supporting technical cooperation activities. The methodology for measuring the cost of supporting technical cooperation on a comparable basis for the five main agencies as established by an external consultant for the UNDP support costs successor arrangements includes the following categories:

(a) The costs of Professional- and General Service-level staff working on any aspect of the project cycle, including identification, formulation, backstopping and evaluation;

(b) The costs of Professional- and General Service-level staff in administrative services directly working on project support, including project personnel services, training services, procurement and contract services, and financial management of technical cooperation;

(c) Part of the costs of branch/section and divisional management to the extent that staff in such organizational units contribute to project support activities (under categories (a) and (b) above);

(d) The share in the cost of Financial Services, Personnel Services and Buildings Management supporting the staff and services listed above (under categories (a), (b) and (c));

(e) Part of the travel costs, consultants, equipment and telecommunications costs to the extent that these support technical cooperation activities, but are not chargeable to specific project budgets.

9. An analysis of UNIDO costs shows that the operational budget income from the reimbursement of support costs is sufficient to cover only a part of the cost components categorized above. The question of the scope and content of the operational budget therefore relates to the question which of the above costs should be covered from the operational budget, and consequently, which should be financed by the regular budget.

D. Support cost reimbursement methodology

10. Prior to the introduction of the UNDP successor arrangements for agency support costs in mid-1992, the reimbursement rate for support costs for all sources of funds was, with a few minor exceptions, a flat 13 per cent of project expenditures. This rate, which was set by the UNDP Governing Council, did not take into account actual support costs, which varied widely depending on the nature of the projects and the implementing agency.

11. This simple system was changed with the introduction of the UNDP successor arrangements. The new arrangements provide for the reimbursement of administrative and operational service (AOS) costs at varying rates depending on the nature of the services provided. In addition, direct payment is made for technical services provided by the Organization at two levels: (a) at the programme level (TSS-1); and (b) at the project level (TSS-2). For projects and programmes financed from other (non-UNDP) sources of funds, the 13 per cent is largely still being applied.

12. An essential feature of the successor arrangements as decided by Member States is the continuation of cost-sharing between UNDP and the executing/implementing agency to which the project is assigned. UNDP provides a standard reimbursement for support costs for the services as outlined in paragraph 11 above, leaving the rest of the costs to be financed by the agency concerned. The ratio of this cost sharing, therefore, varies with the different components of the successor arrangements as well as between agencies.

13. The support costs reimbursement under the old 13 per cent system was not targeted to any specific component of the costs categorized in paragraph 8 above. Under the UNDP successor arrangements, the TSS-1 and TSS-2 reimbursements are intended to finance Professional-level technically specialized staff (category (a)). AOS is intended largely for administrative services (category (b)) and to some extent Professional-level specialized staff involved in providing AOS services (category (a)).

14. It follows from the above that the support costs reimbursement income should be used in the first instance to finance staff under categories (a) and (b). The only additional costs that would be eligible under the above criteria would be costs related to increasing the productivity of the staff concerned, i.e. equipment directly related to technical cooperation activity support.

15. The changes in cooperation with UNDP that were introduced by the successor arrangements for agency support costs do not in themselves alter the scope of the operational budget. However, the three separate categories of support activities established could lead to changes in the composition of services provided by UNIDO to UNDP-financed activities.

II. RELATIONSHIP TO THE REGULAR BUDGET

16. As Annex II to the Constitution stipulates, the regular budget finances the programme support costs arising from technical cooperation projects, to the extent that those costs are not reimbursed to the Organization by the source of financing of such projects. This "cost sharing" concept of programme support costs was also decided by Member States in UNDP Governing Council decision 90/26.

17. The independent team of experts (see para. 2 above) recommended that: (a) the operational budget resources not be used for activities other than the service and support of technical cooperation; and (b) the operational budget resources be used predominantly for activities, the need for which varies in direct ratio with the nature and volume of technical cooperation projects (cf. PBC.5/16, para. 123).

18. Two aspects are important in the relationship of the operational budget to the regular budget: (a) the nature of the support costs (see categories (a) to (e), para. 8 above) that will be financed by the regular budget; and (b) the amount of regular budget resources used to finance costs incurred in support of technical cooperation activities.

19. The nature of the support costs that would be financed from the reimbursements to the operational budget when following the recommendations of the independent team of experts is defined in paragraph 14 above (categories (a) and (b)). The regular budget would finance support costs related to the management of organizational units involved in technical cooperation and the organizational and physical infrastructure, including financial and personnel services and buildings management (categories (c), (d) and (e), para. 8 above). In addition, the regular budget finances the staff directly involved in technical cooperation to the extent that this cannot be funded from the support cost reimbursement income earned, i.e. the residual costs under categories (a) and (b) in paragraph 8 above.

20. The extent to which the regular budget is used to finance costs in support of technical cooperation activities is largely dependent on:

(a) The volume of technical cooperation activities and the actual level of support cost reimbursement received;

(b) The cost efficiency of UNIDO in providing technical cooperation services;

(c) Changes in exchange rates, because costs are largely incurred in Austrian schillings, whereas the reimbursements are in United States dollars;

(d) The ability within the operational budget to respond to sudden changes in the level of technical cooperation activity by adjusting expenditure levels.

21. The extent to which the regular budget has supported technical cooperation activities since 1990-1991 can be seen in the following table.

22. The ability of UNIDO to identify the components of cost, to determine the level of regular budget support and to consider options to control costs is dependent on a reliable system of

Regular budget support to technical cooperation activities, 1990-1995

(In thousands of United States dollars)

	1990-1991	1992-1993	1994-1995	
			Budget	Revised
Reimbursement income from all technical cooperation activities (A)	37,853	30,933	40,500	25,000
Total cost of supporting technical cooperation (B)	109,853	106,800	103,599	91,987
Excess of support costs over reimbursed income (C) = (B-A)	72,000	75,867	63,099	66,987

cost identification. An element of the successor arrangements provides for an independent measurement of the costs of providing the various services across the five main agencies. The cost measurement reports demonstrate that UNIDO's level of costs are comparable to that of the other executing agencies. As a result of the cost measurement analysis, a number of options to improve both the cost effectiveness of certain services as well as the recovery rate of costs have been identified. One of the important options for improvement for non-UNDP-funded technical cooperation activities relates to direct charging of projects for technical services, which is similar to the TSS-2 facility for UNDP projects.

23. A second option to improve cost efficiency is to consider the impact of the size of individual projects. Projects with a relatively low financial value have a disproportionate requirement for technical services causing a relatively higher level of support costs.

III. PRIORITIES AND STRUCTURAL REFORM OF UNIDO

24. The structural reform of UNIDO continues to emphasize the role of the Organization in providing demand-driven direct technical assistance to developing countries. The reform recognizes the need to move away from the provision of many small unrelated technical cooperation projects towards emphasis on comprehensive programmes of technical cooperation activities. This may lead eventually to a higher recovery rate of support costs than at present.

25. The priorities and structural reform of UNIDO do, however, provide an opportunity to reassess the methodology governing the allocation of operational budget resources to UNIDO programmes.

26. In allocating resources in recent programme and budgets, an attempt has been made to follow the recommendations of the team of experts referred to in paragraph 17 above. Although the programmes providing administrative, operational and technical support to projects were identified, the lack of detailed cost analyses made allocations of resources arbitrary to some extent.

27. The restructured UNIDO more clearly identifies those programmes providing administrative and operational services (e.g. Operational Support Division) and those providing technical and operational services (e.g. Industrial Sectors and Environment Division). This improved structure, together with the availability of detailed cost measurements referred to in paragraph 22 will, in future, assist in determining the allocation of operational budget resources to those programmes directly providing the services.

28. The reduction in levels of UNDP resources available to the specialized agencies and the impact of the successor arrangements compels UNIDO to become more demand oriented and competitive. The need to identify new sources of funding for technical cooperation activities is clearly addressed in the reformed UNIDO. The importance

of funds mobilization in ensuring that UNIDO plays an effective role in technical cooperation led to the establishment of a separate major programme devoted to this activity.

IV. FUTURE BUDGETS

29. The close relationship and interdependence of the regular and operational budgets will remain an important feature of UNIDO programme and budgets. The budgets will continue to present the resource allocations indicating the source of funding as either regular or operational budget.

30. The Secretariat will endeavour to ensure that future allocations of operational budget resources will be to programmes providing direct support to technical cooperation activities in direct ratio to the volume of those activities. This will be facilitated by the cost measurement reports prepared for the five main specialized agencies which provide the percentages of time spent by technical and support staff on operational and regular budget activities respectively.

31. In the short term, the reduction in the volume of technical cooperation caused by the sudden decrease in UNDP financing for such projects is affecting the operational budget income. To ensure that the capacity of the Secretariat to support technical cooperation activities is not eroded by further reductions in resource availability under the operational budget, it is hoped that Member States will provide additional voluntary contributions to the Organization for technical cooperation activities and, in particular, to the Industrial Development Fund. Provided the resources in the operational budget are used to provide direct support to technical cooperation activities and can be adjusted in line with changes in the level and categories of services demanded, stabilization of the operational budget and the potential to respond to growth should be assured.

V. CONCLUSION

32. The above review highlights the recent improvements made in categorization and measurement of support costs, which may serve as a basis for improved cost efficiency and a more rational allocation of operational budget resources. The impact on UNIDO operations of the changing relationship with UNDP and of the restructuring and reform process and the extent of regular budget support to the operational budget will continue to be kept under review.

33. Specifically, in future programme and budgets the Organization will allocate operational budget resources to those programmes that carry out the services for which the Organization is reimbursed, in proportion to the amount of time the programme allocates to such services (categories (a) and (b) in para. 8 above).

VI. ACTION REQUIRED OF THE BOARD

34. The Board may wish to take note of the contents of the present report.

Annex
TECHNICAL COOPERATION EXPENDITURES AND SUPPORT COST REIMBURSEMENT, BY SOURCE OF FUNDING, 1987-1993
(In millions of United States dollars)

Source of funding	1987		1988		1989		1990		1991		1992		1993	
	\$	%	\$	%	\$	%	\$	%	\$	%	\$	%	\$	%
UNDP	70.7	72.4	78.0	65.1	82.3	61.5	96.0	60.2	76.1	51.6	58.9	43.4	41.1	34.6
Other														
IDF	16.6		19.8		23.0		27.9		27.7		29.3		27.3	
Other trust funds	6.1		14.2		16.5		25.7		31.2		34.8		29.7	
Other	2.2		5.3		5.7		5.5		6.7		10.2		10.9	
Subtotal	24.9	25.5	39.3	32.8	45.2	33.8	59.1	37.0	65.6	44.5	74.3	54.8	67.9	57.2
UNIDO regular budget	2.1	2.1	2.5	2.1	6.3	4.7	4.5	2.8	5.8	3.9	2.4	1.8	9.7	8.2
Total	97.7		119.8		133.8		159.6		147.5		135.6		118.8	
	=====		=====		=====		=====		=====		=====		=====	
Support cost reimbursement	13.0	a/	17.2		16.9		21.1		19.2		17.6		14.9	

a/ Estimated.